

AUDITED FINANCIAL STATEMENTS

St. Joseph Health Services of Rhode Island

Years Ended September 30, 2007 and 2006

St. Joseph Health Services of Rhode Island

Audited Financial Statements

Years Ended September 30, 2007 and 2006

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Report of Independent Auditors

Board of Trustees
St. Joseph Health Services of Rhode Island

We have audited the statements of financial position of St. Joseph Health Services of Rhode Island (the Corporation) as of September 30, 2007 and 2006, and the related statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Corporation's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of St. Joseph Health Services of Rhode Island at September 30, 2007 and 2006, and the results of its operations and changes in net assets, and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the accompanying consolidated financial statements, in 2007 the Corporation changed its method of accounting for its defined benefit pension plan.

Ernst & Young LLP

January 5, 2008

St. Joseph Health Services of Rhode Island

Statements of Financial Position

	September 30			September 30	
	2007	2006		2007	2006
Assets			Liabilities and net assets		
Current assets:			Current liabilities:		
Cash and cash equivalents	\$ 8,759,436	\$ 7,595,024	Accounts payable	\$ 6,750,786	\$ 8,401,879
Investments	13,493,661	23,281,956	Deferred revenue	1,604,913	196,327
Patient accounts receivable, less reserves of \$7,434,000 in 2007 and \$10,877,000 in 2006 for estimated uncollectible accounts	25,787,427	25,524,554	Accrued expenses	6,947,792	7,693,252
Other receivables	1,699,706	1,765,401	Estimated settlements due to third-party payors	15,357,399	23,334,424
Inventories	2,425,216	2,117,617	Current installments of long-term debt	460,000	435,000
Current portion of assets held by trustees under loan indenture	1,024,627	1,052,345	Current obligations under capital leases	1,501,857	1,651,864
Current portion of pledges receivable, net	77,504	102,504			
Prepaid expenses	541,889	1,386,477	Total current liabilities	32,622,747	41,712,746
Total current assets	53,809,466	62,825,878			
Assets whose use is limited:			Insurance reserves	2,940,119	2,756,594
Held by trustees under loan indenture	1,626,990	1,601,091	Pension liability	10,300,802	3,095,350
Beneficial interest in perpetual trust	6,713,613	5,826,358	Capital lease obligations	5,431,584	4,259,489
Held by trustee under workers' compensation program	779,905	844,121	Asset retirement obligation	2,718,162	2,732,346
Endowment funds	1,122,066	899,599	Long-term debt, excluding current installments	19,523,133	19,720,986
	10,242,574	9,171,169	Total liabilities	73,536,547	74,277,511
Long-term investments	397,536	626,188			
Property, plant and equipment, net	48,170,734	45,657,087	Net assets:		
Pledges receivable, net	86,810	164,313	Unrestricted	29,501,409	35,458,367
Deferred financing costs	408,787	420,728	Temporarily restricted	2,276,034	2,276,024
			Permanently restricted	7,801,917	6,853,461
Total assets	\$ 113,115,907	\$ 118,865,363	Total net assets	39,579,360	44,587,852
			Total liabilities and net assets	\$ 113,115,907	\$ 118,865,363

See accompanying notes.

St. Joseph Health Services of Rhode Island

Statements of Operations and Changes in Net Assets

	Years Ended September 30	
	2007	2006
Unrestricted revenues, gains and other support:		
Net patient service revenue	\$ 172,251,756	\$ 171,094,062
Other operating revenue	6,240,416	6,575,608
Net assets released from restriction	180,842	144,989
Total revenues, gains and other support	178,673,014	177,814,659
Operating expenses:		
Salaries and benefits	106,738,102	102,284,690
Supplies and services	53,336,452	55,167,682
Licensing fee	4,919,485	4,919,485
Interest	1,467,557	1,462,592
Depreciation and amortization	5,473,206	4,769,874
Provision for bad debts	9,140,374	9,760,662
Total operating expenses	181,075,176	178,364,985
Deficiency of revenues over expenses	(2,402,162)	(550,326)
Change in unrealized gains on investments	68,631	(27,171)
Adjustment to minimum pension liability	—	819,541
Net assets of H.E.L.P. Lead Safe Center assumed	—	(10,000)
Cumulative effect of change in accounting principle for adoption of FIN 47	—	(2,732,346)
Cumulative effect of change in accounting principle for adoption of FAS 158	(4,572,794)	—
Net assets released from restrictions used for purchase of property and equipment	949,367	268,738
Decrease in unrestricted net assets	(5,956,958)	(2,231,564)

St. Joseph Health Services of Rhode Island

Statements of Operations and Changes in Net Assets (continued)

	Years Ended September 30	
	2007	2006
Temporarily restricted net assets:		
Contributions	\$ 1,060,757	\$ 754,877
Change in unrealized gains on investments	69,462	63,681
Assets released from restriction	(1,130,209)	(413,727)
Increase in temporarily restricted net assets	10	404,831
Permanently restricted net assets:		
Contributions	50,200	130,102
Change in unrealized gains on investments	898,256	102,509
Increase in permanently restricted net assets	948,456	232,611
Decrease in net assets	(5,008,492)	(1,594,122)
Net assets at beginning of year	44,587,852	46,181,974
Net assets at end of year	<u>\$ 39,579,360</u>	<u>\$ 44,587,852</u>

See accompanying notes.

St. Joseph Health Services of Rhode Island

Statements of Cash Flows

	Years Ended September 30	
	2007	2006
Operating activities		
Change in net assets	\$ (5,008,492)	\$ (1,594,122)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	5,473,206	4,769,874
Restricted contributions	(1,110,957)	(884,979)
Adjustment of minimum pension liability	—	(819,541)
Net unrealized gains on investments	(1,036,349)	(139,019)
Cumulative effect of change in accounting principle for adoption of FIN 47	—	2,732,346
Cumulative effect of change in accounting principle for adoption of FAS 158	4,572,794	—
Net assets assumed of H.E.L.P. Lead Safe Center	—	10,000
Changes in:		
Patient accounts receivable	(262,873)	(5,863,083)
Accounts payable	(1,651,093)	1,039,357
Estimated settlements to third-party payors	(7,977,025)	2,027,262
Other assets and liabilities	4,067,809	2,823,982
Net cash (used in) provided by operating activities	(2,932,980)	4,102,077
Investing activities		
Purchases of property and equipment	(5,297,298)	(6,119,373)
Net assets assumed of H.E.L.P. Lead Safe Center	—	(10,000)
Decrease (increase) in investments	10,007,790	(5,227,540)
Decrease (increase) in assets whose use is limited under bond indenture	1,819	(39,235)
Net cash provided by (used in) investing activities	4,712,311	(11,396,148)
Financing activities		
Proceeds from long-term debt	425,000	—
Payments on capital lease obligations	(1,638,379)	(1,305,390)
Payments of long-term debt	(615,000)	(410,000)
Decrease in pledges receivable	102,503	124,759
Restricted contributions	1,110,957	884,979
Net cash used in financing activities	(614,919)	(705,652)
Increase (decrease) in cash and cash equivalents	1,164,412	(7,999,723)
Cash and cash equivalents at beginning of year	7,595,024	15,594,747
Cash and cash equivalents at end of year	\$ 8,759,436	\$ 7,595,024
Non cash items:		
Equipment acquired through capital lease	\$ 2,660,467	\$ 4,892,566

See accompanying notes.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements

September 30, 2007

1. Organization

St. Joseph Health Services of Rhode Island (the Corporation) is an integrated, multilevel, multihospital, healthcare delivery system whose operating divisions serve Rhode Island and Southeastern New England. Core values, as defined by the Corporation's "mission statement," are consistent with the healing ministry of the Catholic Church.

Our Lady of Fatima Hospital in North Providence, a community-based medical center, offers a wide array of inpatient acute-care services, including medical and surgical services, a variety of subspecialties, an emergency department and comprehensive outpatient diagnostic services on-site and at satellite diagnostic centers. It features a regionally recognized critical care pavilion, an ambulatory care center, the state's largest endoscopy center, leading-edge laser technology, hyperbaric medical services and other modern diagnostic services, such as MRI, PET and CT scanner services. Its medical staff has a strong community-based primary care presence, in addition to an extensive selection of specialists.

The St. Joseph Hospital for Specialty Care in Providence offers a wide variety of sophisticated specialty services in addition to the nationally recognized Center for Health and Human Services, an integrated network of primary care and specialty clinics serving the economically disadvantaged and minority populations. Its Center for Psychiatric Services offers comprehensive inpatient adult and geriatric services, in addition to outpatient mental health services on-site and at off-site locations. St. Joseph Hospital for Specialty Care also features the Southern New England Rehabilitation Center, a partnership with Rhode Island Hospital, offering tertiary-level medical rehabilitation for stroke, head and spinal cord trauma, and various other medical conditions. A skilled nursing facility is also operated at St. Joseph Hospital for Specialty Care. Outpatient rehabilitation services are also available through a network of locations. St. Joseph Hospital for Specialty Care is also home to Corporate Care, an occupational health and safety service working with small and large businesses throughout Rhode Island.

In June 2002, the Corporation entered into a joint venture with MRI Centers of N.E. and opened Northwest Rhode Island Imaging in Johnston, RI. The Corporation's investment in the venture is recognized within long-term investments on an equity basis.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

1. Organization (continued)

The Corporation also operates the St. Joseph School of Nursing and the St. Joseph Living Center. The latter is an assisted-living facility, and serves the emergent needs of the elderly population who desire residential living but require assistance with daily tasks. Respite care services are also provided.

The hospitals are licensed for 386 beds and are fully accredited by the Joint Commission on Accreditation of Hospitals. All operating units have received full licensure and are fully accredited by the numerous various regulating bodies. The hospitals are Medicare certified, participate in the Medicaid program and have contracts with Blue Cross and other health maintenance organization programs currently operating in the market.

On October 27, 2004 the Corporation assumed the activates and net assets of the H.E.L.P. Lead Safe Center (a not for profit Rhode Island Corporation). The merged organization was previously renting space within the Hospital and provided services to families within the community who are affected by lead poisoning. Under this agreement the Corporation assumed \$236,082 in unrestricted net assets. The Hospital will continue the activities of the former organization in conjunction with other lead safety initiatives.

2. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Corporation considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, excluding amounts whose use is limited by board designation or other arrangements under trust agreements.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

Inventories

Inventories, consisting primarily of drugs and supplies, are stated at the lower of cost (first-in, first-out) or market.

Deferred Financing Costs

Deferred financing costs represent the costs associated with the issuance of the 1999 revenue bonds (see Note 8). These costs are being amortized proportionate to the bond maturities. Issuance costs are reported net of accumulated amortization of \$85,885 and \$73,944 at September 30, 2007 and 2006, respectively.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful life of each class of depreciable assets.

Equipment under capital lease is amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. This amortization is included in depreciation and amortization expense in the financial statements.

Investments

Investments in equity and debt securities are reported at fair value in the statements of financial position. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities. The Corporation accounts for investments in joint ventures and partnerships using the equity method, with the Corporation's share of the earnings (loss) on these ventures and partnerships included in other operating revenue. Distributions from joint ventures, expected to be received within the next year, are classified as current assets.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

In accordance with the Hospital's interpretation of the relevant state laws, realized and unrealized gains on endowment and specific purpose funds increase permanently and temporarily restricted net assets, respectively.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by or for the Corporation in perpetuity. Permanently restricted net assets consist primarily of the Corporation's beneficial interest in the Townsend Fund, the income from which is available to support services rendered by the Corporation.

Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors and others for services rendered, and includes estimated retroactive revenue adjustments due to future audits and reviews. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits and reviews.

The Healthcare Financing Administration (HCFA) approved a Medicaid disproportionate share plan for the State of Rhode Island. As a result, the Corporation received \$7,849,674 in 2007 and \$8,567,494 in 2006 from Medicaid, which is included in net patient service revenue in the statements of operations and changes in net assets.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received. Conditional promises to give are reported at fair value at the date the condition is satisfied. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions.

Excess of Revenue over Expenses

The statements of operations and changes in net assets include the excess of revenues over expenses. Changes in unrestricted net assets, which are excluded from the excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, changes in the minimum pension liability and contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, were to be used for the purposes of acquiring such assets).

Income Taxes

The Corporation is a not-for-profit hospital as described in section 501(c)(3) of the Internal Revenue Code, and is exempt from federal income taxes on related income pursuant to section 501(a) of the Code.

The Corporation has losses from unrelated business activity of approximately \$426,000. A potential deferred tax asset of approximately \$170,000 is offset by a corresponding valuation allowance.

Asset Retirement Obligation

Effective September 30, 2006, the Corporation adopted the provisions of Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47"). Under FIN 47, the Corporation recorded an asset retirement obligation liability related to the estimated future costs of \$2,732,346 to remediate asbestos in certain buildings. Previously, such costs were accounted for as they were incurred. The cumulative effect of adopting this change in accounting principle as of September 30, 2006, represents a decrease in unrestricted net assets of \$2,732,346. During 2007, the Hospital recorded \$171,180 in asbestos abatement costs and \$156,996 accretion.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

New Accounting Standards

On September 29, 2006, the FASB issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*. The new standard applies to all plan sponsors who offer defined benefit postretirement benefit plans. Statement No. 158 requires an entity to recognize in its balance sheet an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status, measure a defined benefit postretirement plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in changes in unrestricted net assets in the year in which the changes occur.

Statement No. 158 does not change the amount of net periodic benefit cost included in the excess of revenue over expenses or address the various measurement issues associated with postretirement benefit plan accounting. The requirement to recognize the funded status of a defined benefit postretirement plan and the disclosure requirements are effective for the year ending September 30, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for the year ending September 30, 2009.

In June 2006, the FASB issued Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* (FIN 48), which is effective for financial statements for fiscal years beginning after December 15, 2006. FIN 48 provides guidance to all enterprises, including pass-through entities, for how uncertain tax provisions should be recognized, measured, presented and disclosed in the financial statements. The Corporation is evaluating the potential impact, if any of FIN 48 upon adoption.

In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements*. FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosure about fair value measurements. FAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Corporation has not yet determined the effect that the adoption of FAS No. 157 will have on its financial statements.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. FAS No. 159 permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. FAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Corporation has not yet determined the effect that the adoption of FAS No. 159 will have on its financial statements.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation.

3. Charity Care and Community Services

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. During 2007 and 2006, the Corporation provided charity care of \$5,968,265 and \$5,319,920, respectively, measured using established rates.

In addition to the above-mentioned medical care rendered, the Corporation provides numerous other services to the community, free of charge. These services include such things as providing access to health care through interpreters, referral and transportation services, health care screening, community support groups, health educational programs, physician services and general community benefit services such as emergency preparedness programs. The cost of services provided to the community with revenues foregone were \$261,680 in 2007 and \$587,467 in 2006.

In addition to the cost of charity care and other community service programs, the Corporation provided \$9,140,373 and \$9,760,662 for uncollectible patient accounts during the years ended September 30, 2007 and 2006, respectively.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

4. Investments

The composition of investments at September 30, 2007 and 2006 is set forth in the following table. Investments are stated at fair value.

	2007	2006
<i>Assets whose use is limited</i>		
Held by trustee under loan indenture agreements:		
Money market funds	\$ 2,651,617	\$ 2,653,436
	<u>\$ 2,651,617</u>	<u>\$ 2,653,436</u>
Beneficial interest in perpetual trust:		
Marketable equity securities	\$ 4,380,917	\$ 2,735,072
Bonds and notes	294,031	1,835,162
Mutual funds	1,675,049	1,098,810
Money market funds	363,616	157,314
	<u>\$ 6,713,613</u>	<u>\$ 5,826,358</u>
Held by trustee under workers' compensation program:		
Money market funds	\$ 779,905	\$ 844,121
	<u>\$ 779,905</u>	<u>\$ 844,121</u>
Endowment funds:		
Money market funds	\$ 458,985	\$ 86,094
U.S. Treasury obligations	663,081	813,505
	<u>\$ 1,122,066</u>	<u>\$ 899,599</u>

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

4. Investments (continued)

	2007	2006
<i>Other investments</i>		
Current assets:		
U.S. Treasury obligations	\$ 789,028	\$ 1,518,831
Certificates of deposit	806,531	807,423
Fixed income mutual funds	473,061	452,171
Money market funds	11,425,041	20,503,531
	<u>\$ 13,493,661</u>	<u>\$ 23,281,956</u>
Long-term investments:		
Investment in partnership	\$ 134,700	\$ 316,308
Investment in joint ventures	262,836	309,880
	<u>\$ 397,536</u>	<u>\$ 626,188</u>

The investment return is comprised of the following for the years ended September 30, 2007 and 2006:

	2007	2006
Included in other operating revenue:		
Interest income	\$ 1,002,125	\$ 1,248,589
Income from partnership	134,442	314,789
Loss from joint ventures	(11,860)	(79,000)
	<u>\$ 1,124,707</u>	<u>\$ 1,484,378</u>
Unrealized investment gains (losses) included in changes in net assets:		
Unrestricted	\$ 68,631	\$ (27,171)
Temporarily restricted	69,462	63,681
Permanently restricted	898,256	102,509
	<u>\$ 1,036,349</u>	<u>\$ 139,019</u>

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

5. Property, Plant and Equipment

Property, plant and equipment, by major category, is as follows at September 30:

	2007	2006
Land and improvements	\$ 1,654,911	\$ 1,632,319
Buildings and improvements	60,525,782	60,163,285
Furniture and equipment	61,050,895	49,131,772
Construction in progress	2,071,967	6,766,660
	125,303,555	117,694,036
Less accumulated depreciation and amortization	77,132,821	72,036,949
Property, plant and equipment, net	<u>\$ 48,170,734</u>	<u>\$ 45,657,087</u>

6. Pledges Receivable

Pledges receivable and the allowances for uncollectible pledges at September 30 are as follows:

	2007	2006
Less than one year	\$ 77,504	\$ 102,504
One to five years	122,496	211,849
	200,000	314,353
Less unamortized discount	25,686	31,826
	174,314	282,527
Less allowance for uncollectibles	10,000	15,710
	<u>\$ 164,314</u>	<u>\$ 266,817</u>

A discount rate of 6.0% was used for the years ended September 30, 2007 and 2006.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

7. Line-of-Credit

The Corporation has an agreement with a bank providing for working capital borrowings up to \$4,000,000. These borrowings, which bear interest at the bank's prime rate, are unsecured. No amounts were outstanding under the line-of-credit agreement at September 30, 2007 and 2006.

8. Long-Term Debt and Capital Leases

Long-term debt consists of the following:

	September 30	
	2007	2006
Obligations under Rhode Island Higher Education Hospital Financing Revenue Bonds, Series 1999, net of original issue discount of \$776,867 and \$794,014 at September, 30 2007 and 2006, respectively; interest rates of 3.50% to 5.50%, due serially to October 1, 2029; interest is payable semiannually at April 1 and October 1 of each year; secured by a pledge of the Corporation's gross receipts and mortgage of certain property	\$ 19,558,133	\$ 19,975,986
Less current installments	(460,000)	(435,000)
Note payable	425,000	180,000
	<u>\$ 19,523,133</u>	<u>\$ 19,720,986</u>

During 1999, the Corporation issued Rhode Island Health and Educational Building Corporation Hospital Financing Revenue Bonds, Series 1999, in the amount of \$23,145,000. These proceeds were used to refinance all of the Corporation's then-outstanding long-term debt and capital leases of \$9,025,000, and provide \$14,120,000 to be used for capital projects.

The required annual principal payments of long-term debt in the years ending September 30, 2007 through 2011 are \$460,000, \$480,000, \$510,000, \$535,000, and \$560,000, respectively, with the remaining balance of long-term debt outstanding of \$17,785,000, due serially through October 1, 2029.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

8. Long-Term Debt and Capital Leases (continued)

The obligations under the Rhode Island Higher Education Hospital Financing Revenue Bonds have specific covenants with which the Corporation must comply. At September 30, 2007 and 2006, the Corporation was in compliance with these financial covenants. In addition, the Corporation is required to maintain certain deposits with a trustee. At September 30, 2007 and 2006, such deposits, which are included in assets whose use is limited, are summarized as follows:

	<u>2007</u>	<u>2006</u>
Debt service fund	\$ 1,024,627	\$ 1,052,345
Debt service reserve fund	1,626,990	1,601,091
	<u>\$ 2,651,617</u>	<u>\$ 2,653,436</u>

Cash paid for interest during 2007 and 2006 amounted to \$1,479,302 and \$1,473,662, respectively.

In 2002, the Corporation entered into a loan agreement with SJHS Imaging Center, Inc. in the amount of \$180,000. The unsecured loan was to pay for the Corporation's share of build-out costs associated with opening SJHS Imaging Center, Inc. The five-year loan payable carries an interest rate of 8.625%, payable in "interest only" installments until June 2007. At September 30, 2007 this debt was satisfied.

In 2007, the Corporation entered into a subordinated loan agreement with the Inter-Parish Loan Fund, Inc. in the amount of \$850,000. The loan was to pay for fire code renovations at the St. Joseph Living Center. The ten-year loan payable carries an interest rate of 5% payable in monthly installments of \$9,015 until November 2017. At September 30, 2007, the Hospital received an initial disbursement of \$425,000. The final disbursement of \$425,000 was received on November 15, 2007.

Capital Leases

The Hospital classifies certain noncancelable leases as capital leases and includes the property under lease in its property and equipment along with the related accumulated depreciation.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

8. Long-Term Debt and Capital Leases (continued)

Future minimum lease payments due under capital lease arrangements at September 30, 2007 are as follows:

2008	\$ 1,718,729
2009	1,669,336
2010	1,618,511
2011	1,288,580
2012	1,288,580
Total minimum lease payments	<u>7,583,736</u>
Less amount representing interest	<u>650,295</u>
Present value of net minimum lease payments	<u><u>\$ 6,933,441</u></u>

9. Operating Leases

The Corporation has entered into noncancelable operating lease agreements with several vendors for the lease of certain computer, radiology and other equipment. Total rental expense amounted to \$2,980,143 and \$3,238,530 for the years ended September 30, 2007 and 2006, respectively. Future minimum payments as of September 30, 2007, under noncancelable operating leases, are as follows:

2008	\$ 1,171,525
2009	685,809
2010	322,992
2011	222,067
2012	177,410
	<u><u>\$ 2,579,803</u></u>

10. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Capital projects	\$ 1,755,551	\$ 1,924,291
Operating activities	445,219	280,164
Educational	75,264	71,569
	<u><u>\$ 2,276,034</u></u>	<u><u>\$ 2,276,024</u></u>

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

10. Temporarily and Permanently Restricted Net Assets (continued)

Permanently restricted net assets at September 30, 2007 and 2006 are restricted to:

	<u>2007</u>	<u>2006</u>
Investments to be held in perpetuity, the income from which is available to support health care services	\$ 7,720,788	\$ 6,772,532
Investments to be held in perpetuity, the income from which is available to support education	81,129	80,929
	<u>\$ 7,801,917</u>	<u>\$ 6,853,461</u>

11. Pension Plan

The Corporation's defined benefit pension plan covers substantially all of the Corporation's employees. Plan participants' benefits are computed as a percentage of final average earnings (five highest consecutive rates of annual earnings over the last ten years of employment) less a percentage of Social Security benefits, proportionately reduced for services less than thirty years. Although the plan is not subject to ERISA, the Corporation's policy is to fund at least the minimum amount required under the ERISA guidelines. Effective October 1, 2007, the Hospital froze participation in the defined benefit pension plan for all new non-union and FNHP Bargaining Unit employees. These new employees will be eligible to participate in a defined contribution plan once certain requirements are met.

Change in Accounting Principle

In September 2006, the FASB issued SFAS No. 158. The new standard applies to all plan sponsors that offer defined benefit postretirement benefit plans. SFAS No. 158 requires an entity to recognize in its statement of financial position an asset, for a defined benefit postretirement plan's overfunded status, or a liability, for a plan's underfunded status; measure a defined benefit postretirement plan's assets and obligations that determine funded status as of the end of the employer's fiscal year; and recognize the periodic change in the funded status of a defined benefit postretirement plan as a component of changes in unrestricted net assets in the year in which the change occurs.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

11. Pension Plan (continued)

SFAS No. 158 does not change the amount of net periodic benefit cost recognized or address various measurement issues associated with postretirement benefit plan accounting. Such issues are being reconsidered by the FASB. The requirement to recognize the funded status of its defined benefit pension plan and related disclosure requirements with a corresponding adjustment to other changes in unrestricted net assets was adopted by the Corporation as of September 30, 2007.

The effect of the change in accounting principle upon adoption of SFAS No. 158 represents the net unrecognized actuarial loss and unrecognized prior service cost, both of which previously were netted against the plan's funded status in the Corporation's statements of financial position pursuant to the provisions of SFAS No. 87. These amounts will be subsequently recognized as net periodic pension cost pursuant to the Corporation's historical accounting policy for amortizing such amounts, as indicated in SFAS No. 87. Further, actuarial gains and losses that arise in subsequent periods which are not recognized as net periodic pension cost in the same periods will be recognized as a component of other changes in unrestricted net assets, such amounts will be recognized subsequently as a component of net periodic pension cost through amortization.

The effect of adopting SFAS No. 158 at September 30, 2007, decreased the Corporation's unrestricted net assets by \$4,572,794. The adoption of SFAS No. 158 had no effect on the Corporation's excess of revenues and non-operating gains over expenses for the years ended September 30, 2007 or 2006, and it will not affect the Corporation's operating results in future periods.

Included in unrestricted net assets at September 30, 2007 are the following amounts that not yet been recognized in net periodic pension cost: prior service cost of \$3,954,639 and unrecognized actuarial losses of \$618,155. The prior service cost and actuarial loss included in unrestricted net assets and expected to be recognized in net periodic pension cost during the year ending September 30, 2008 are \$562,761 and \$0, respectively

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

11. Pension Plan (continued)

The components of the net periodic benefit cost for each of the plans for the years ended September 30, 2007 and 2006 are as follows:

	2007	2006
Service cost	\$ 2,990,452	\$ 3,490,374
Interest cost	7,326,325	6,783,246
Expected return on plan assets	(8,778,647)	(8,143,838)
Prior service cost amortization	562,761	562,761
Amortization of actuarial loss	531,767	813,457
Net periodic cost	<u>\$ 2,632,658</u>	<u>\$ 3,506,000</u>

The weighted-average assumptions used to determine net periodic benefit cost as of September 30, 2007 and 2006, are as follows:

	2007	2006
Discount rates	6.25%	5.25%
Rates of increase in future compensation levels	3.50%	3.50%
Expected long-term rate of return on plan assets	8.75%	8.75%

A reconciliation of the changes in the Corporation's Retirement Plan projected benefit obligations and the fair value of assets for the years ended September 30, 2007 and 2006, and a statement of funded status of the plans as of September 30 for both years, follows:

	2007	2006
Changes in benefit obligations		
Projected benefit obligations at beginning of year	\$ 118,012,294	\$ 124,384,703
Service cost	2,990,452	3,490,374
Interest cost	7,326,325	6,783,246
Benefits paid	(4,514,443)	(3,481,436)
Experience loss	1,204,996	(13,164,593)
Projected benefit obligation at end of year	<u>\$ 125,019,624</u>	<u>\$ 118,012,294</u>

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

11. Pension Plan (continued)

	2007	2006
Changes in plan assets		
Fair value of plan assets at beginning of year	\$ 102,323,479	\$ 94,837,161
Actual return on plan assets	16,909,786	10,967,754
Benefits paid	(4,514,443)	(3,481,436)
Fair value of plan assets at end of year	<u>\$ 114,718,822</u>	<u>\$ 102,323,479</u>
Funded status		
Funded status of the plan	\$ (10,300,802)	\$ (15,688,815)
Unrecognized net loss	—	8,076,065
Unrecognized prior service costs	—	4,517,400
Net pension liability	<u>\$ (10,300,802)</u>	<u>\$ (3,095,350)</u>

The weighted-average assumptions used to determine the pension benefit obligation at September 30, 2007 and 2006 are as follows:

	2007	2006
Discount rates	6.25%	6.25%
Rates of increase in future compensation levels	3.50%	3.50%
Expected long-term rate of return on plan assets	8.75%	8.75%
Measurement date	June 30, 2007	June 30, 2006

The accumulated benefit obligation as of September 30, 2007 and 2006 was \$100,396,618 and \$93,420,272, respectively. Under the requirements of Statement of Financial Accounting Standards No. 87, *Employers Accounting for Pensions*, an additional pension liability of \$819,541, representing the excess of accumulated benefits over plan assets and accrued pension costs, net of the intangible asset to the extent of unrecognized prior service costs, was recognized at September 30, 2005. There was no additional minimum pension liability at September 30, 2006.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

11. Pension Plan (continued)

Plan Assets

The primary investment objective of the Corporation's defined benefit pension plan is to provide pension benefits for its members and their beneficiaries by ensuring a sufficient pool of assets to meet the Plan's current and future benefit obligations. These funds are managed as permanent funds with disciplined longer-term investment objectives and strategies designed to meet cash flow requirements of the plan. Although the plan is not subject to ERISA, funds are managed in accordance with these and all other regulatory requirements.

Management of the assets is designed to maximize total return while preserving the capital values of the fund, protecting the fund from inflation, and provide liquidity as needed for plan benefits. The objective is to provide a rate of return that meets inflation, plus 5.0%, over a long-term horizon.

The plan aims to diversify its holdings among sectors, industries and companies.

A periodic review is performed of the pension plan's investment in various asset classes. The current asset allocation target is 70% equities and 30% fixed income.

The Corporation's pension plan asset allocations at September 30, 2007 and 2006, by asset category are as follows:

	Plan Assets at September 30	
	2007	2006
Marketable equity securities	75%	78%
U.S. government obligations and corporate bonds	23	20
Other	2	2
Total	100%	100%

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

11. Pension Plan (continued)

Contributions

The Corporation is not required to make a contribution to its pension plan in 2007.

Estimated Future Benefit Payments

Benefit payments, which reflect expected future service, are expected to be as follows:

<u>Fiscal Year</u>	<u>Pension Benefits</u>
2008	\$ 3,902,340
2009	4,207,990
2010	4,561,744
2011	4,913,944
2012	5,293,348
Years 2013–2017	35,366,498

12. Professional Liability Insurance

The Corporation insures its professional liability risks pertaining to medical malpractice on a claims-made basis. From October 1, 1998 to October 1, 2001, the Corporation was insured for professional liability loss contingencies by an insurance company that, on August 16, 2001, was placed into rehabilitation by the insurance commissioner of the Commonwealth of Pennsylvania. The Corporation has established reserves to cover professional liability exposure that may not be covered by current or prior insurance policies, including a reserve for estimated claims incurred but not reported to the insurance company.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

13. Workers' Compensation

As of December 1, 1999, the Corporation obtained commercial insurance for its workers' compensation liability. The Corporation maintains a stop-loss insurance policy for workers' compensation claims made prior to December 1, 1999. Accordingly, amounts up to the stop-loss limit are self-insured by the Corporation. The Corporation has accrued its estimate of the ultimate potential workers' compensation loss based upon an actuarial study, which developed the estimated loss based upon actual paid claims. The estimated ultimate losses were discounted using a rate of five percent. In order to provide for the ultimate payment of the estimated loss, the Corporation has deposited amounts into a trust that are sufficient to fund the estimated liability. In addition, the Corporation has posted a \$650,000 surety bond.

14. Third-Party Payment Arrangements

The Corporation maintains agreements with the Social Security Administration under the Medicare program, the State of Rhode Island under the Medicaid Program, Blue Cross of Rhode Island and United Health Plans of New England, among others, that govern payment to the Corporation for services rendered to patients covered by these programs.

Medicare utilizes a prospective payment system for inpatient medical surgical, rehabilitation and transitional care services where payment is based on the classification of a case into a diagnosis-related group (DRG). Inpatient psychiatric nonacute services related to Medicare beneficiaries are paid based on cost up to a specified limit. Medicare outpatient services are paid on a prospective payment system based upon ambulatory payment classifications (APC). The method of payment for Rhode Island Blue Cross is a per diem system for inpatient services and a negotiated fee schedule for outpatient services.

The majority of Rhode Island Medicaid patients are reimbursed under the RiteCare program funded by the State of Rhode Island. The RiteCare program is administered by area insurance companies and HMOs. Most of the Corporation's revenue from the RiteCare program is through United Health Plans of New England and Neighborhood Health Plan and payments are based upon per diems for inpatients and fee schedules for outpatient services. Medicaid patients not included in the RiteCare program are reimbursed based on budgeted costs under a prospective cost contract and reimbursement is adjusted based upon actual patient volume.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

14. Third-Party Payment Arrangements (continued)

The Corporation has entered into contracts with other insurance companies and health maintenance organizations whereby they are generally paid on a per-diem or case rate (DRG) basis for inpatients and fee schedules for outpatient services.

Cost reports filed annually with third-party payors are subject to audit prior to final settlement. The Corporation has settled with Medicaid through 2006, and with Medicare through 2005.

Revenues from the Medicare and Medicaid programs accounted for approximately 33% and 7%, respectively, of the Corporation's gross patient revenue for the year ended September 30, 2007. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. The Corporation believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation. There is at least a reasonable possibility that recorded amounts could change by a material amount in the near term. Differences between amounts previously estimated and amounts subsequently determined to be recoverable or payable are included in net patient service revenues in the year that such amounts become known. Such differences (decreased) increased revenues by approximately \$2,946,000 and \$(758,000) for the years ended September 30, 2007 and 2006, respectively.

During fiscal 2007 and 2006, hospitals in Rhode Island were subject to a state license fee based on a percentage of gross charges, which is reflected as an expense in the statement of operations. The license fee was \$4,919,485 for the both years ended September 30, 2007 and 2006.

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

15. Concentrations of Credit Risk

The Corporation grants credit to patients, substantially all of whom are local residents. The Corporation generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations and commercial insurance policies).

The mix of receivables from patients and third-party payors at September 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Medicare	33%	36%
Blue Cross	17	17
Medicaid	7	7
Health maintenance organizations	36	34
Private insurance	3	2
Workers' compensation	1	1
Self-pay	3	3
	<u>100%</u>	<u>100%</u>